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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

HDI-GERLING AMERICA INSURANCE COMPANY, a New York Corporation, Plaintiff, vs. HOMESTEAD INSURANCE COMPANY, an Pennsylvania Corporation; GREAT AMERICAN E&S INSURANCE COMPANY, an Ohio Corporation, formerly known as AGRICULTURAL EXCESS AND SURPLUS INSURANCE COMPANY, and DOES 1-10, Defendants.	CASE NO. CV08-1716PJH **PLAINTIFF HDI-GERLING AMERICA INSURANCE COMPANY'S OPPOSITION TO DEFENDANTS HOMESTEAD INSURANCE COMPANY AND GREAT AMERICAN E&S INSURANCE COMPANY'S MOTIONS TO DISMISS** Date: July 9, 2008 Time: 9:00 a.m. Dept.: 3 (Honorable Phyllis J. Hamilton)

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Plaintiff, HDI-Gerling America Insurance Company ("Gerling") hereby opposes Defendant Homestead Insurance Company's ("Homestead") and Defendant Great American E&S Insurance Company fka Agriculture Excess and Surplus Insurance Company's ("Great American") Motions to Dismiss made to pursuant to Federal Rules of Civil Procedure 12(b)(6).

I. INTRODUCTION

Defendants seek the dismissal of Gerling's Complaint on the grounds that Gerling has not stated a claim for Declaratory Relief and Contribution. As Defendants' motions are based on a misunderstanding of the Federal pleading requirements and the misapplication of California law, they must be denied.

Defendants allege that because Gerling did not extensively quote from Defendants' policies in its Complaint, it has failed to state a cause of action against them. However, under the Federal pleading rules, it is not necessary to state each and every fact or provision that *may be* at issue. All that is necessary to state a valid cause of action is that Gerling make clear and plain allegations by which Defendants can know the claims against them and the basis for such claims. As Gerling's complaint amply meets these requirements, it has stated valid claims against Defendants.

Moreover, Defendants' motions are based on a misrepresentation of California law. Both Homestead and Great American incorrectly argue that California law requires exhaustion of all primary policies before *any* excess policy ever has an obligation to provide coverage. In fact, as is made clear by the case most heavily relied on by Defendants, *Community Redevelopment Agency of the City of Los Angeles v. Aetna Casualty & Surety Company,* 50 Cal.App.4th 329 (1996), whether an excess policy owes an obligation to provide coverage is controlled by the actual language of the policy. Accordingly, an excess policy, by its terms, can have a duty to drop down and provide coverage before all primary policies are exhausted. The Homestead and Great American policies are such policies.

As set forth herein, both the Homestead and Great American policies were written over specifically identified policies scheduled as underlying insurance. Upon exhaustion of those policies, Defendants had a duty to drop down and provide coverage to the insured. Upon dropping down, Defendants' policies became primary policies filling in the gaps in coverage left when the

insurance specifically underlying their policies exhausted. The fact that another policy, Gerling's policy, also provided coverage to the same insured, did not alter Defendants' contractual duty to drop down and provide coverage.

Despite the unambiguous language in their policies' grant of coverage, Defendants argue that the Other Insurance provisions in their policies should control whether the policies have a duty to drop down. This argument fails as it requires the re-writing of the policies' insurance agreement which has been specifically rejected by the Courts. Further, as other insurance provisions only adjudicate coverage between insurers on the same level, it can not control an excess policy's attachment point.

Once the underlying primary exhausted, Defendants also had a duty to defend their insured as the generic other insurance language in their defense provisions has been found to be an unenforceable escape clause. Further, due to their settlement contributions in one of the underlying cases, Defendants, in equity owe Gerling a proportionate share of the defense fees in that action.

As set forth herein, Homestead and Great American had a duty to contribute, along with Gerling, to the defense and indemnity of their insured in the underlying actions that are the subject of this litigation. As Defendants refused to do so, Gerling has valid claims for Contribution and Declaratory Relief against Defendants.

Pursuant to LR 7-4, the issue to be decided by Defendants' motions is whether Defendants have shown that there is *no* basis upon which Gerling can state any valid claim against Homestead or Great American for: 1) Declaratory Relief; or 2) Contribution based on Defendants' duty to defend or duty to indemnify Jonce in either of the Underlying Actions.

II. FACTS

In this case, Gerling is seeking contribution from Homestead and Great American due to their wrongful refusal to provide coverage to the carriers' mutual insured, Jonce Thomas Construction Company, Inc. (hereinafter, "Jonce") in two construction defect actions entitled *Emery Bay II Associates v. Devcon Construction Incorporated, et al.*, Alameda County Superior Court Case Number RG04144077, and *Chartwell HOA, et al. v. 44 Third Street, Ltd. LP, et al.*, Santa Clara County Superior Court Case Number 1-03-CV-814851 (collectively "the Underlying Actions").

(Complaint ¶ 6).

Gerling issued a policy to Jonce that was in effect for *two months* from June 30, 1995 to September 9, 1995. (Complaint ¶ 9) In comparison, Homestead issued four umbrella policies to Jonce that were in effect from June 30, 1994 to June 30, 1998.[1] (Complaint ¶ 10) Great American issued four umbrella policies to Jonce that were in effect from June 30, 1998 to February 6, 2002. (Complaint ¶ 20)

By their specific terms, both the Homestead and Great American policies were excess only to specific policies named and identified in their policies' schedule of underlying insurance. (Complaint ¶¶ 11-16; 21-26) The policies specifically underlying Homestead's policies were issued by United National, AIG and American Equity.(Complaint ¶¶ 13-16) The policies specifically underlying Great American's policies were issued by New Market, Newmarket and Lloyds of London. (Complaint ¶¶ 23-26) Each of these underlying policies exhausted prior to the settlement of the Underlying Actions. (Complaint ¶¶ 17-19; 27-28)

Upon exhaustion of those underlying policies, Defendants had a duty to drop down and provide coverage to Jonce in the Underlying Actions. (Complaint ¶¶ 11-16; 21-26) However, when that exhaustion occurred, Defendants refused to either defend or indemnify Jonce. (Complaint ¶¶ 31-36; 40-45) Due to Homestead and Great American's refusal to provide coverage to Jonce, Gerling, even though it had only issued a policy that was effect for 60 days, was forced on its own to defend and indemnify Jonce in the Underlying Actions. (Complaint ¶¶ 32,34, 36,41-43; 45-47) It was only after Gerling's policy was exhausted that Defendants contributed to the settlement of the Underlying Actions. (Complaint ¶¶ 36;45)

III. LEGAL ARGUMENT

A. Gerling's Complaint States Valid Causes of Action Against Both Homestead and Great American, Therefore, Defendants' Motion to Dismiss Must be Denied

Gerling's complaint meets the requirements of the Federal pleading rules for stating valid claims against both Homestead and Great American. Pursuant to Federal Rules of Civil Procedure

[1] Gerling is not seeking coverage under the Homestead's policy no. UL-04314.

("FRCP"), Rule 8(a)(2), a complaint requires only a "short and plain statement of the claim showing that the pleader is entitled to relief." Accordingly, a complaint is sufficient if it gives the defendant "fair notice of what the . . . . claim is and the grounds upon which it rests." *Bell Atlantic Corp. v. Twombly,* ___ US___,127 S. Ct 1955, 1959 (2007) (citing to *Conely v. Gibson* 355 U.S. 41, 47- 48 (1957)). In reviewing the sufficiency of a complaint, the issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support its claims. *Gilligan v. Jamco Development Corp.*, 108 F.3d. 246, 248 (9th Cir. 1997).

Gerling's complaint meets these requirements. As evidenced in Defendants' motions to dismiss, there is no confusion over the claims Gerling is asserting against Homestead and Great American. Defendants do not dispute that Gerling is alleging that, based on their policies' language, Defendants owed a duty, concurrent with Gerling's, to defend and indemnify their mutual insured, Jonce, in the Underlying Actions.

Rather, Defendants allege that because Gerling has not quoted certain provisions in their policies in the Complaint, Gerling's complaint is defective. However, it is not necessary for Gerling to have cited to each and every provision in Defendants' policies, which Defendants allege to be at issue, to state a valid claim. It is sufficient under the Federal Rules for a plaintiff to notify a defendant that it has breached its particular contract by not performing a certain action and to reserve further details until discovery. *The New Hampshire Insurance Company v. Marine Max of Ohio, Inc.,* 408 F.2d 526 (6th Cir. 2006). In *New Hampshire*, New Hampshire argued, pursuant to a 12(b)(6) motion, that Marine Max was required in its complaint to identify the provision of the New Hampshire policy under which it was entitled to coverage. The Court disagreed, stating that it was sufficient for Marine Max to simply notify New Hampshire that it had breached a particular contract by not performing a certain action and to reserve further certain details until discovery. The Court found that New Hampshire was on notice that Marine Max claimed some provision of the policy entitled it to coverage and was free to ask Marine Max what those provisions were in discovery. *Id.* at 529. On that basis, the Court denied New Hampshire's 12(b)(6) motion to dismiss.

Homestead's reliance on *Twaite v. U.S.F. & G. Insurance Company,* 216 Cal.App.3d 239, 252 (1990), is misplaced. *Twaite* is a California case and as such it does not address Federal

pleading rules which apply here. Further, the case addressed the ruling on a motion for summary judgment for breach of contract not a motion on the pleadings relating to claims for declaratory relief and contribution.

Moreover, as set forth *infra*, there is no policy language quoted by either Defendant in their motions which acts as a complete bar to Gerling's claims. Accordingly, the additional policy provisions cited by Defendants do not make Gerling's Complaint "fatally defective" but are in fact, irrelevant to the issue of whether Gerling has stated valid claims against Defendants.

As Gerling's complaint gives Defendants fair notice of the claims against them and the grounds upon which those claims rest, Defendants' motions to dismiss must be denied.

Further, as this case is still in the pleading stage, no discovery has been conducted. Not only have the parties not made their initial disclosures but no written discovery or depositions have taken place. Gerling is entitled to conduct discovery on the policies, including but not limited to, Defendants' underwriting of the policies, the insured's interpretation of the policies, and whether the terms of the policies have been modified by any later agreements. Thus, at this stage in the litigation, there is a question of fact as to whether all of the relevant evidence is before the Court regarding the application of these policies. Without such discovery, Gerling is also not in a position to know whether the policies attached to Defendants' motions are, in fact, authentic versions. For this reason, Gerling specifically objects to Defendants' use of the copies of Defendants' policies attached of their motions.

B. Defendants Owed a Duty to Provide Coverage to Jonce Once the Specific Insurance Underlying Their Policies had Exhausted.

Contrary to Defendants' assertions, there is no absolute rule requiring the horizontal exhaustion of all primary policies before an excess carrier can ever owe a duty in California. Instead, policies are interpreted based upon their language. "Clear and explicit" policy language governs; there is no room for judicially-created rules unrelated to policy language. *Bank of the West v. Superior Court (Industrial Indemnity Co.)*, 2 Cal.4th 1254 (1992). In keeping with these general rules, case law regarding when an excess policy "attaches" or drops down (owes an obligation) has also held that the specific language of the policy governs. *Community Redevelopment Agency of the*

City of Los Angeles v. Aetna Casualty & Surety Co., 50 Cal.App.4th 329 (1996); *Travelers Casualty Ins. Co. v. Transcontinental Ins. Co.*, 122 Cal.App.4th 949 (2004). *Community Redevelopment* did not rule that "horizontal exhaustion" governs all cases dealing with excess insurance. Rather, the court made clear, that whether an excess carrier has a duty to drop down upon exhaustion of the insurance specifically underlying its policies (*i.e.*, vertical exhaustion) or whether all primary policies must exhaust before it has an obligation (*i.e.*, horizontal exhaustion) depends on the controlling language in the policies at issue: "if an excess policy states that it is excess over a specifically described policy, and will cover a claim when the specific primary policy is exhausted, such language is sufficiently clear to overcome the usual presumption that *all* primary coverage must be exhausted." *Community Redevelopment,* 50 Cal.App.4th at 339-340.

On the facts of the case, the Court found that the Scottsdale policy at issue specifically stated *in its insuring agreement* that its obligation would be excess, not only of the policy specifically underlying the Scottsdale policy, but, "*the applicable limits of any other underlying insurance collectable by the insured.*" *Id.* at 338. (Emphasis Added.) On that basis, the Court found that all underlying primary policies had to exhaust before the Scottsdale policy had an obligation. However, the Court's ruling was limited to the language of the policy before it and the Court explicitly recognized that an excess policy could have duty to drop down and take the place of underlying insurance if the language of the excess policy so dictated. *Id.* at 332, 339-340. Contrary to Defendants' assertions, the actual language of an excess policy's insuring agreement determines when the policy attaches.

Similarly, in *20th Century Insurance Company v. Liberty Mutual*, 965 F.2d, 747 (9th Cir. 1992), an excess insurer Admiral, which had issued a policy that was excess to only specifically named policies, argued that *despite its policy language*, California law required that all primary policies exhaust before an excess policy had an obligation. On that basis, Admiral argued that its policy attached only after exhaustion of *any* underlying insurance, not just the specifically underlying insurance as required by its policy. The Court rejected that argument stating that despite Admiral's contention that its policy was excess over all other insurance, the language of the policy was to the contrary. Accordingly, the Court found that the Admiral policy dropped down and acted as a

primary policy upon exhaustion of the specific underlying Liberty Mutual policy.

Here, the insuring agreements of both the Homestead and Great American policies specify that the policies are excess to specifically named policies (the Homestead policies) or that the policies are excess to primary insurance applicable during the same policy period. In both cases, vertical, not horizontal exhaustion, is appropriate.

1. *Homestead Owed a Duty to Provide Coverage to Jonce Once the Specific Insurance Underlying its Policies Exhausted.*

The Homestead policies were clearly written over specifically identified policies scheduled as underlying insurance, not over any insurance no matter when procured or what it covers. In their insuring agreement, the Homestead policies obligate the insurer to:

> pay those sums that the insured must legally pay as damages because of .. . property damage ... caused by an occurrence which occurs during the policy period of this policy in excess of the sums payable as damages in the underlying insurance or would have been payable but for the exhaustion of the applicable limit of insurance. (Complaint ¶¶ 10-12)

The policies define "underlying insurance" as "the insurance policies listed in Schedule A-Schedule of Underlying Insurance Policies." The policies in listed in Schedule A were issued by United National, AIG and American Equity. (Complaint ¶¶ 12-16) Each of these policies were exhausted before settlement of the Underlying Actions. (Complaint ¶¶ 17-19).

The policies do not state that Homestead's obligations is excess to all other primary insurance, or all applicable insurance, scheduled or not. Instead the policies are specific in naming the policies over which Homestead provided excess coverage. Based on the plain language of each of its policies, Homestead had a duty to drop down and act as primary insurance *on the sole condition* that specifically named underlying insurance issued by United National, AIG and American Equity primary policies were exhausted.

Despite this clear language, Homestead argues that its policies require horizontal exhaustion citing to *Community Redevelopment.* However, Homestead simply ignores the reasoning of *Community Redevelopment* and the language of its own policies. In *Community Redevelopment*, the insuring agreement at issue stated:

> The Company shall be liable for the Ultimate Net Loss in excess of the greater of the Insured's (A) underlying limit An amount equal to the Limits of Liability indicated

> beside the underlying insurance listed in the Schedule of Underlying Insurance (Schedule A), *plus, the applicable limits of any other underlying insurance collectable by the insured.* [emphasis added.] *Community Redevelopment,* 50 Cal.App.4th at 333.

Unlike the *Community Redevelopment* policies, the Homestead policies do not reference any other underlying insurance in their insuring agreement or in the definition of "underlying insurance." They do not state that Homestead will pay damages in excess of any other underlying insurance. They state that Homestead will pay damages in excess of policies listed in a schedule. Stated simply, the Homestead policies do not require horizontal exhaustion of all primary policies before they are triggered.

In actuality, the Homestead language is the same as the language at issue in *Travelers Casualty Ins. Co. v. Transcontinental Ins. Co.,* 122 Cal.App.4th 949 (2004), in which the Court found that the policy was a "specific excess" policy to which vertical exhaustion applied. Following the ruling in *Community Redevelopment*, the Court in *Travelers* held that vertical exhaustion was appropriate where the language of the policy dictated that the excess policy had to drop down on the sole condition that specifically named underlying insurance was exhausted.

In *Travelers*, the umbrella policy's insuring agreement obligated the insurer to pay damages under Coverage A when a loss exceeded the applicable limits of underlying insurance, as stated in a schedule, or under Coverage B when a loss was in excess of a certain limit or the amount payable by "other insurance, whichever is greater." Similarly, with respect to defense, the policy stated that there would be a duty to defend under Coverage A when "the applicable limit of 'underlying insurance' has been exhausted by payment of claims" or, under Coverage B, when no underlying or other insurance applied. Although other primary insurance was available to a cover a loss, the Court ruled that where the specifically named underlying insurance was exhausted, the plain language of the umbrella policy obligated the insurer to drop down and participate in the defense and indemnity of the claim.

The Court noted that the policy made a clear distinction between Coverage A and Coverage B, as coverage under B required the absence of all other coverage, while Coverage A did not. Further, the Court distinguished *Community Redevelopment*, holding that the language of the policy

before it was "'sufficiently clear'" to trigger the carrier's defense obligation upon the exhaustion of specifically named underlying insurance, "regardless of the existence or exhaustion of other insurance." *Travelers,* 122 Cal.App.4th at 959.

Here, the language of the Homestead policy states that it will pay claims for property damage for sums in excess of underlying insurance, which it defines as specifically scheduled insurance. The language is different from that in *Community Redevelopment*, in which the policies at issue stated indemnity was owed for "ultimate net loss in excess of the greater of the insured's : (a) Underlying limit – an amount equal to the limits of liability indicated beside the underlying insurance listed in the Schedule of Underlying Insurance. . . *plus the applicability limits of any other underlying insurance collectible by the insured*. . ." [emphasis added]. Accordingly, upon exhaustion of the underlying United National, AIG and American Equity policies, Homestead had a duty to drop down and provide coverage to Jonce.

2. *Great American Owed a Duty to Provide Coverage to Jonce Once the Specific Insurance Underlying its Policies Exhausted.*

The Great American policies also required Great American to drop down and provide coverage to Jonce before exhaustion of the Gerling policy. The Great American policies' insuring agreement obligated Great American to:

> pay on behalf of the "Insured" those sums in excess of the "Retained Limit" that the "Insured" becomes legally obligated to pay by reason of liability imposed by law . . . The amount we will pay for damages is limited as described below in the insuring agreement Section II. Limits of Insurance. (Complaint ¶ 20-21)

The policies define "Retained Limit" as: "the greater of: 1. the total amounts stated as the applicable limits of the underlying policies listed in the schedule of insurance and the applicable limits of any other insurance providing coverage to the "insured" during the Policy Period . . . ." (Complaint ¶ 22). "Underlying Insurance" is defined in the policies in pertinent part as: "the insurance coverage provided under the policies shown in the Schedule of Insurance, or additional policies agreed to by us in writing." The policies in listed in schedule of insurance were issued by New Market, Newmarket and Lloyds of London. (Complaint ¶¶ 23-26). Each of these policies were exhausted before settlement of the Underlying Actions. (Complaint ¶¶27-28).

While the insuring agreement in the Great American policies states that the policies are also excess over any other insurance providing coverage to the "insured" *during the Policy Period*, Great American does not allege that there was any other primary insurance issued to Jonce during the time period of its policies (June 30, 1998 through February 6, 2002) other than the already exhausted policies specifically listed in the schedules of underlying insurance.

As Gerling's policy was in effect for only two months, three years prior to the first Great American policy, it did not provide coverage to Jonce during the time period of the Great American policies. Therefore, pursuant to the insuring agreement, the Great American policies are not excess of the Gerling policy but instead, have a duty to drop down and share with Gerling in providing coverage for Jonce in the Underling Actions.

Great American heavily relies on *Padilla Construction Company, Inc. .v. Transportation Insurance Company*, 150 Cal App 4th 984 (2007) to support the contention that its policies require horizontal exhaustion. However, *Padilla* is easily distinguishable on its facts. In *Padilla,* an insured sought coverage from its Umbrella carrier to cover the gap in coverage due to a $25,000 Self Insured Retention ("SIR") under its primary policy. The Umbrella Carrier's policy specifically stated in its insuring agreement that it was excess over all scheduled and unscheduled underlying insurance. *Id.* at 994-995. On this basis, the Court held that all of the underlying primary policies had to exhaust before the Umbrella policy had an obligation including the primary policy with the SIR.

The Great American policy does not contain *Padilla* language in its insuring agreement. Instead, underlying insurance is limited to policies issued during the policy period. Accordingly, *Padilla* has no bearing on Great American's drop down obligation.

Similarly, the Limits of Insurance section in the Great American policies does not control when Great American has an obligation under its policies. The purpose of a policy's Limits of Insurance section is to describe how much the insurer is obligated to pay under a policy *once* the policy is triggered. It does not control at what point an obligation arises under a policy. This distinction is, in fact, made clear by the portion of Great American's insuring agreement which states: "the amount we will pay for damages is limited as described below in . . .Section II. Limits of Insurance."

If Great American had wanted to require the exhaustion of all other insurance prior to its policies having an obligation, it should have put that the policies were excess of *all other underlying insurance* in the Retained Limit section of its policies. As it did not, it can not now claim that its policies require horizontal exhaustion. Based on the attachment point laid out in the insuring agreement and the retained limit definition in its policies, Great American had an obligation to participate with Gerling in providing coverage to Jonce for the Underlying Actions.

With respect to both Homestead and Great American, the actual language of Defendants' policies controls when their obligation to Jonce arose. The insuring agreements in the policies issued by both of the two carriers obligate each of them to provide coverage upon the exhaustion of specifically listed primary policies. As Gerling's policy is not one of those policies, the fact that Gerling had not yet exhausted, did not impact Defendants' obligation to drop down and provide coverage for Jonce in the Underlying Actions. As both Homestead and Great American refused to do so, Gerling has stated valid claims for Declaratory Relief and Contribution against Defendants.

C. Defendants' Obligation to Provide Coverage For the Underlying Actions is Not Controlled by the Other Insurance Provisions in Their Policies

Despite the specific language in their insuring agreements, Defendants argue that they do not have an obligation to drop down upon exhaustion of the specifically underlying primary policies based on "other insurance" provisions in the Conditions sections of their policies. Defendants are wrong for two reasons: first, other insurance provisions do not determine when an excess policy attaches, as they are applicable only to determining allocations between carriers on the same level; second, assuming that the Homestead and Great American policies should have dropped down in the Underlying Actions, such that they were on the primary layer, these provisions would have to be evaluated on equal footing with the other insurance provision of the Gerling policy. Such an evaluation cannot be made here, as the policies are not properly before the court. Moreover, the case law is abundantly clear that other insurance provisions cannot be enforced unless there is no conflict between them. Here, there is a conflict.

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1. Other Insurance Provisions Do Not Determine Whether Horizontal Or Vertical Exhaustion is Appropriate.

"Other insurance" provisions do not control when an excess policy attaches, but rather would come into play with regard to Gerling only after the excess policy dropped down to the primary layer. It is well established under California law that other insurance provisions apply only to policies in the same layer. Stated differently, other insurance clauses become relevant only where several insurers insure the same risk at the same level of coverage; an other insurance dispute cannot arise between excess and primary carriers. *Dart Industries, Inc. v. Commercial Union Ins. Co.*, 28 Cal.4th 1059, 1079 (2002); *Reliance National Indemnity Co. v. General Star Indemnity Co.*, 72 Cal App.4th 1063, 1077 (1999); *Travelers Casualty & Surety Company v. American Equity Insurance Company* 93 Cal.App.4th 1142 (2001) ["An other insurance clause dispute cannot arise between an excess and primary carriers as they are not 'on the same level'"]; *Carmel Development Company v. RLI Insurance Company*, 126 Cal.App.4th 502 (2005); *North River Insurance Company v. American Home Assurance Company,* 210 Cal.App.3d 108 (1989) [holding that "other insurance" provisions "only become[] an issue when two or more policies apply at the same level of coverage. An 'other insurance' dispute can only arise between carriers on the same level, it cannot arise between excess and primary insurers"]. The purpose of the other insurance provision is to determine allocation between carriers on the same level, insuring the same risk; they do not dictate whether an excess policy requires vertical or horizontal exhaustion before it has an obligation to provide coverage.

In fact, the argument that the other insurance provision controls an excess policy's point of attachment has been specifically rejected by the Courts. *Travelers Casualty, supra,* 122 Cal.App.4th 949; *Carmel Development Company v. RLI Insurance Company*, 126 Cal.App.4th 502 (2005). In *Travelers,* the Court held that "[r]ead in the context of these other 'conditions,' the provisions of the 'Conditions' section set forth rights, obligations and interpretative aids 'applicable to' coverage under the policy rather than conditions that must be fulfilled prior to the existence of coverage." The Court reiterated the general rule that provisions which take away or limit coverage, "must be conspicuous, plain and clear." If the other insurance provision were interpreted to require the exhaustion of all other insurance prior to attachment of the excess policy, the carrier would have

limited its coverage in the "boiler plate" conditions section of the policy without indicating that limitation in the insuring agreement or supplemental payments provision. "If Federal intended to have coverage be dependent upon the exhaustion of 'other insurance' it was required to make such an exclusionary clause conspicuous, plain, and clear. It did not do so." *Travelers*, 122 Cal.App.4th at 958.

Travelers reflects a basic principle in interpreting insurance contracts: provisions which take away or limit must be "conspicuous, plain and clear" to be enforeceable. *DeMay v. Interinsurance Exchange of Auto Club of Southern California*, 32 Cal.App.4th 1133, 1137 (1995); *Travelers, supra*, 122 Cal.App.4th 949. Here, as in *Travelers,* Defendants argue that even though the insuring agreements of their policies are clear, a boiler-plate condition should limit their obligations. However, to hold that the "other insurance" provision determines when an excess policy attaches would be to elevate its impact on coverage over the impact of the insuring agreement. The general rule that other insurance provisions apply only to policies at the same level should apply and should dictate that the provision does not establish that Defendants are entitled to the rule of horizontal exhaustion.

Community Redevelopment does not support Defendants' contention that the other insurance provision trumps the clear intent of the insuring agreement in their policies. In that case, the policies' insuring agreement specifically stated that the policy was excess to scheduled and unscheduled underlying insurance. In citing to the policy's other insurance provision, the Court merely found that it was consistent with the requirements of the insuring agreement. *Community Redevelopment,* 50 Cal.App.4th at 329. Here, Defendants cannot transform what are specific excess policies into ones that require the exhaustion of all primary insurance based upon a boiler plate condition.

Recognizing that a limitation on its coverage must be somehow be read into the insuring agreement, Great American argues that the other insurance provision in its policies applies because the insuring agreement references the Limits of Insurance provision, which, in turn, states that it is "subject to the terms and conditions of this policy," and the other insurance provision is a condition. The logic of this argument is tortured and contrary to the rule that limitations on coverage must be

"conspicuous, plain, and clear."

Moreover, the argument is not new, and has, in fact been rejected by the California courts. In *Carmel Development*, a Fireman's Fund excess policy stated in its insuring agreement that "subject to the other provisions of this policy, we will pay on behalf of the insured those funds in excess of primary insurance that the insured becomes legally obligated to pay as damages." *Id.* at 509. Though the language of the insuring agreement required the policy to drop down upon exhaustion of the specific underlying primary issued by Reliance, Fireman's Fund argued that based on the language "subject to the other provisions of this policy," the other insurance clause was incorporated into the insuring agreement. On that basis, Fireman's Fund took the position that its policy required horizontal exhaustion of all primary policies before it had an obligation.

The Court rejected this argument holding that:

> Fireman's Funds 'insuring language did not clearly and unequivocally inform the insured that it was excess over all other insurance, primary and excess, but buried its limitation on the second to last page in a generally worded "other insurance" clause, a condition generally accorded judicial disfavor. *Id.* at 511.

Consequently, the Court found that its other insurance language did not trump the language of its insuring agreement and that Fireman's Fund undertook to provide coverage immediately upon exhaustion of the underlying Reliance policy limits. *Id.* at 510-511.

Pursuant to *Travelers, Carmel Development* and *American Equity,* Defendants cannot use the "other insurance" provisions in their policies to require exhaustion of all primary insurance and block the obligation set forth in their insuring agreements to drop down and provide coverage for the Underlying Actions upon exhaustion of the underlying policies specifically identified in their policies.

2. Defendants' Arguments That Their Policies' Other Insurance Provisions Eliminate Their Obligations Here, are Premature and Not Supported by the Law.

Homestead argues that even if its policies had a duty to drop down upon exhaustion of the specific underlying primary policies and participate on the same level with Gerling, the Homestead policies are, nonetheless, still excess to the Gerling policy due to the Homestead's policies' other insurance provision. This argument fails for a number of reasons.

First, in determining an allocation for a loss among multiple carriers on the same layer, other insurance provisions are generally disfavored as they are used by carriers to seek exculpation whenever the loss falls within another's policy. *CSE Ins. Group v. Northbrook Property & Casualty Co.,* 23 Cal.App.4th 1839, 1845 (1994). Thus, when there are competing excess-only and pro-rata other insurance clauses in the same layer of coverage, the excess only provision is disregarded, and the carriers pro-rate the loss. *Id.* [pro-ration is the favored method of apportioning a loss among those who have contracted to insure against it]; *Pacific Indemnity Co. v. Bellefonte Ins. Co.,* 80 Cal.App.4th 1226, 1235 (2000) [equitable contribution principals require proration between excess and pro rata other insurance provisions]; *Commerce & Industry Ins. Co. v. Chubb Custom Ins. Co.,* 75 Cal.App. 4th 739 (1999) [pro-rating loss between excess only and pro-rata provisions]; and *Fireman's Fund v. Maryland Casualty,* 65 Cal.App.4th, 1279, 1304 (1998) [conflicting excess only and pro-rata provisions required to pro-rate.] Pursuant to this well-established rule of pro-ration, regardless of whether any of the policies at issue here contain pro-rata or excess only other insurance clauses, the coverage for the Underlying Actions should be pro-rated between the three carriers.

Moreover, in the rare instance that a Court has found no conflict between other insurance provisions, it has done so based on a narrowly tailored provision which, by agreement, shifted the loss to one carrier. In *Hartford Casualty Insurance Co. v. Travelers Indemnity Co.,* 110 Cal.App.4th 710 (2003), Travelers' other insurance provision stated that its policy was excess only in the event that its insured, Cornerstone, was an additional insured under any other policy. The other carrier, Hartford, insured Cornerstone as an additional insured. On this basis, the Court found that the other insurance provisions in Travelers and Hartford's policies did not conflict stating:

> Both policies declare themselves to be excess in the situation where the parties and the insurers are most likely to intend that result – when the insured is covered as an additional insured on another party's policy for some specific event or situation. A clause that carves out this intended exception to primary coverage is not similar to an escape clause, where the insurer appears to offer coverage that in fact evaporates in the presence of other insurance. *Id.* at 727.

The Court also found that Hartford knew it had issued additional insured coverage and, therefore, accepted the risk providing primary coverage to Cornerstone before Travelers.

In contrast, both of Defendants' other insurance provisions are generic excess only

provisions. Neither of them carve out a specific narrow situation in which their policies are excess. Therefore, the narrow exception to the pro-ration rule discussed in *Hartford* does not apply in this case. Since the other insurance provisions in Defendants' policies do not control Defendants' duty to drop down, Gerling has alleged valid claims for Declaratory Relief and Contribution.

Second, application of other insurance provisions cannot be adjudicated in a vacuum. The provision is only relevant in relation to the other insurance provisions in the competing policies that are on the same level. Accordingly, for this argument to have any merit, all of the policies at issue in this case, including the Gerling policy, must be before the Court. Since Homestead has not attached a copy of the Gerling policy nor is it possible for it to do so, the Gerling policy is currently not before the Court. Therefore, this argument can not be raised on a motion on the pleadings.

For these reasons, Homestead's argument that its policies' other insurance provisions would result in it having no obligation, even if it did have an obligation to drop down after specifically defined policies exhausted, is both premature and incorrect.

D. Defendants had a Duty to Defend Jonce Prior to the Exhaustion of the Gerling Policy

As set forth above, Defendants had a duty to drop down and act as primary insurance once the insurance specifically underlying their policies exhausted. Thus, upon exhaustion of the underlying policies, Homestead and Great American dropped down to the same level as Gerling's two-month policy.

Despite this obligation to drop down, Defendants allege that they did not have a duty to defend Jonce in the Underlying Actions. However, Defendants' arguments are based on generic other insurance language that has been found to be an escape clause and, hence, void as against public policy. *USF Insurance Company v. Clarendon American Insurance Company*, 453 F.Supp.2d 972 (2006). In that case, in response to a contribution action brought by USF, Clarendon argued that it had no duty to defend its insured when it was being provided a defense by another carrier based on the excess other insurance language contained in its defense provision.[2] Clarendon argued that as

[2] The defense language in the Clarendon policy was: "Our duty to defend is excess over and shall not contribute where the insured has any other insurance under which, but for the existence of this policy, any other insurer is obligated to provide a defense."

this excess provision did not effect the scope of coverage or its duty to indemnify its insured, but only dealt with its defense obligation, it should be enforced.

The Court disagreed, holding that the excess defense provision was a type of escape clause since it allowed Clarendon to make a seemingly iron clad guarantee that it will defend the insured only to withdraw that guarantee in the presence of other insurance, thereby depriving the insured of the benefit of its bargain. *Id.* at 1000. The Court also found that the excess defense clause was also inequitable from the standpoint of other insurers who had undertaken to defend the insured. The Court held that like excess other insurance provisions, excess defense clauses simply attempt to shift the burden away from one insurer wholly and largely to other insurers and thus are objects of judicial distrust. *Id.* at 1001. Therefore, the Court found that the excess insurance language contained in Clarendon's defense obligation was void as against public policy and, consequently, unenforceable. On this basis, Clarendon was found to have a duty to defend.

As with the Clarendon policy, the defense language at issue in the Homestead and Great American policies contains an unenforceable other insurance provision. Specifically, the Homestead policies state: "we will have no duty to defend any claim or suit that any other insurer has a duty to defend." (Homestead Motion, p.5:9-16). Similarly, the Great American policies state that the carrier will have a duty to defend when "the applicable Limits of Insurance of the underlying policies listed in the Schedule of Underlying Insurance *and the Limits of Insurance of any other insurance providing coverage to the 'insured' have been exhausted.*" [emphasis added.] (Great American Motion, p.6:7-12).

Unlike the language addressed in the *Padilla* case, Defendants' "excess" provisions do not state that the policies have an defense obligation in excess of all *underlying* primary insurance but are generic other insurance provisions inserted into the policies' defense language. Like the Clarendon policy in *USF*, this language makes Defendants' defense obligation excess to *all other policies* not just underlying primary policies. Therefore, its purpose is not to require horizontal exhaustion but to take away the defense obligation in its entirety in the face of any other insurance. Thus, pursuant to *USF*, the excess other insurance language in Homestead and Great American's defense provisions is void as against public policy, and can not be enforced as against Gerling.

Defendants may try to argue that *USF* is inapplicable as it addressed contribution between primary policies. However, as Defendant's policies required them to drop down upon the exhaustion of the directly underlying insurance, once those policies exhausted, Defendants' policies became primary policies on the same level as Gerling's policy.[3] *USF* is directly on point. Accordingly, Defendants had a duty to defend Jonce upon exhaustion of the specifically underlying primary policies.

Moreover, Gerling's policy was in effect for *only two months* from June 30, 1995 to September 9, 1995. Gerling only had an obligation to pay for property damage which occurred during the time period of its policy. In comparison, two of the Homestead policies and four Great American policies provided coverage for the seven years subsequent to Gerling's two month time period. (Complaint ¶¶ 10 and 20). To the extent that any damages at issue in the Underlying Actions arose during the Homestead or Great American policies, such damage took place subsequent to Gerling's policy. Therefore, Gerling would have no duty to defend or indemnify Jonce with respect to such damage. Due to the short two month time period of the Gerling policy, it is extremely likely that this occurred. Therefore, even assuming *arguendo*, that Defendants' other insurance provision in their defense provision is enforceable, there was no other insurance to provide a defense with respect to that damage. In that instance, Defendants had a duty to defend Jonce under their policies.

While Gerling may have had a duty to defend the entire action under the tenets of *Buss v. Superior Court*, 16 Cal 4th 35 (1997), now that it has provided that defense and the case is resolved, Gerling can seek a defense contribution from Defendants for damages that were not covered under its policy. In *Padilla, supra*, 150 Cal App 4th 984, the insured argued that an excess carrier had a duty to pay the amount of an SIR under a primary policy as there was no other insurance which covered the loss for the amount of that SIR. The Court rejected that argument for several reasons including the fact that the SIR could not be detached from the primary policy and the excess policy

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[3] For this same reason, Great American's citing to the case of *Reliance National Indemnity Company v. General Star Indemnity Company*, 72 Cal.App.4th 1063 (1999) for the principal that there is no right of contribution between primary and excess carriers is disingenuous.

contained language in its insuring agreement that it was excess to all scheduled and unscheduled underlying policies. However, in so ruling, the Court acknowledged the possibility of such an carrier bringing an action on this basis. *Id.* at 1000.

As there is a question of fact as to whether any of the damages at issue in the Underlying Actions first arose during one of Homestead or Great American's policies, Gerling has grounds for asserting a claim for Declaratory Relief and Contribution against Defendants based on their failure to defend.

Based on the foregoing, Defendants policies had a duty to drop down and act as primary policies upon exhaustion of the specific policies underlying their insurance. Therefore, Gerling can be granted a declaration and a determination that both Homestead and Great American owed a duty to defend and indemnify Jonce in the Underlying Actions. As such, it is entitled to maintain causes of action against Defendants for both Declaratory Relief and Contribution.

E. Equity Requires that Defendants Reimburse Gerling For a Portion of Jonce's Defense Costs in the *Emery Bay* Action.

Equity requires that an excess carrier share the burden of defending claims that exceed the limits of the underlying coverage. *Aetna Casualty & Surety Co. v. Certain Underwriters at Lloyd's of London*, 56 Cal.App.3d 791 (1976). As both Homestead and Great American paid a portion of the settlement made on behalf of Jonce in the *Emery Bay* action, one of the Underlying Actions, they had a duty to pay a proportionate share of defense costs in that case. (Complaint ¶¶ 35-38,44-47). Accordingly, Gerling is entitled to seek a pro-rata contribution from Defendants for the defense fees incurred in the *Emery Bay* action.

The *Aetna* case involved claims arising from the blowout of an oil well operated by Union Oil. Union Oil's primary carrier, Aetna, undertook the defense and thereafter, advised Union Oil's excess insurers that it was approaching exhaustion and requested that the excess carriers assume the defense. Both refused. After Aetna had paid its indemnity limits, it brought an action against the excess carriers that after paying its indemnity limits, it no longer had a duty to defend. The Court ruled that exhaustion of its policy relieved Aetna of its duty to defend.

In addition, the Court ruled that the total defense of claims were to be apportioned on a pro-

rata basis among all insurers based on the total amount of indemnity payments made by each insurer. Thus, the Court did not limit the excess carriers' defense responsibility to costs incurred *after* the primary carrier exhausted. In so doing, the Court stated:

> [W]e are not considering the rights and obligations between one insured and a single insurer alone. We cannot resolve the dispute by reference to the Aetna contract alone . . . . we interpret the respective duties of all parties in light of several contracts of insurance, the relative portion of the insured and the insurers as well as the nature of the calamity giving rise to these claims. No single rubric nor any composite of selected rules of contract construction can alone decide the unique matter at the bench. *Id.* at 799-800.

In *Signal Companies v. Harbor Insurance Company*, 27 Cal.3d 359 (1985), while the Court found that a primary carrier was not entitled to contribution for defense costs from the excess carrier directly above it, the Court specifically refused to formulate a definitive rule regarding an excess carrier's obligation to share in defense costs with a primary carrier:

> We expressly decline to formulate a definitive rule applicable in every case in light of varying equitable considerations which may arise, and which affect the insured and the primary and excess carriers, and which depend upon the particular policies of insurance, the nature of the claim made, and the relation of the insured to the insurers. . . . The reciprocal rights and duties of several insurers who have covered the same event do not arise out of contract, for their agreements are not with each other . . . . Their respective obligations flow from equitable principals designed to accomplish ultimate justice in the bearing of a specific burden. [Citations Omitted.] *Id.* at 368.

Based on the principals set forth in *Aetna* and *Signal*, where a claim is over the limits of a primary policy, both the primary and excess insurers can be liable for the costs of defense in proportion to the amount paid by each to settle the claim. Accordingly, a primary insurer who is the only one to defend, has an equitable claim for contribution against the insured's excess carriers, since by fulfilling its own duty to defend, it also fulfilled an obligation owed by the other insurers.

In the instant action, Gerling issued a policy that was in effect for *two months*. In comparison, Defendants' policies spanned *seven years*. Gerling received $26,144 in premium from Jonce while Homestead and Great American received, respectively, $151,200 and $218,400. Further, the majority of the damages at issue in the *Emery Bay* case occurred during the time period of Defendants' policies, not Gerling's two month policy. Thus, equity favors that Defendants pay a portion of Jonce's defense costs *even if* their policies are found to not have an immediate defense obligation upon the exhaustion of the directly underlying insurance.

Accordingly, Gerling has an equitable right to seek a pro-rata share of Jonce's defense from Defendants. Further, as a claim in equity is factual intensive, it can not be overcome on a motion to dismiss. Consequently, Defendants' motions must be denied.

F. Homestead and Great American Had a Duty to Indemnify Jonce, Even if They Did Not Owe a Duty to Defend.

While Gerling maintains that Defendants must contribute with respect to defense of the two Underlying Actions, it should be noted that the duty to indemnify and the duty to defend are separate duties under general liability policies. Liability policies usually impose two, separately defined obligations on an insurer: (1) to indemnify the insured against third party claims covered by the policy (by settling the claim or paying any judgment against the insured); and (2) to defend such claims against the insured.

While it has been held that the duty to defend under a standard, primary general liability is broader than the duty indemnify, the California Supreme Court has expressly recognized that an excess policy can have a duty to indemnify where it has no duty to defend. In finding a duty to indemnify on the part of several excess carriers, the Court in *Powerine Oil Company, Inc. v. The Superior Court (Central National Insurance Company)*, 37 Cal.4th 377 (2005), focused on the insuring agreements of the policies before it. The Supreme Court rejected the excess insurers' arguments, based on two landmark opinions,[4] holding that primary policies had no duty to defend or indemnify an insured where a governmental agency had ordered clean-up of a potentially hazardous waste site. In those earlier opinions, the Court had ruled that governmental clean-up orders were not "suits" which had to be defended and did not result in "damages" which had to be indemnified.

Turning to the excess policies, however, the Court refused to hold that there was no duty to indemnify simply because some of the policies had a duty to defend and others did not:

> [U]nlike the standard primary CGL policy, excess/ umbrella policies do not as a matter of course contain a duty to defend, as evidenced by the very policies here in question. From an equitable standpoint, it would be manifestly unfair to penalize the insured for paying a premium to obtain added protection by concluding that the defense coverage endorsements purchased for the seven policies defeat indemnity

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[4] *Foster Gardner, Inc. v. National Union Fire Ins. Co.*, 18 Cal.4th 857 (1998); and *Certain Underwriters at Lloyd's of London v. Superior Court (Powerine Oil Co.)*, 24 Cal.4th 945 (2001).

coverage otherwise clear under the literal policy language.

Powerine, 37 Cal.4th at 404. Where some of the excess policies had insuring agreements which included a duty to defend governmental clean-up costs imposed upon the insureds, the Court would not entertain arguments regarding the duty to indemnify premised upon defense-related endorsements which mimicked the language of the primary policies (which linked defense to the existence of a "suit"). Stated otherwise, the court would not hold that there was no duty to indemnify, simply because some of the excess policies had no duty to defend.

Significantly, the Court in *Padilla* similarly recognized the two separate obligations and limited its own holding to the issue of defense, as between an insured and the umbrella insurer. In *Padilla*, an insured construction company asserted an umbrella carrier had a duty to defend, given allegations of continuing damages in the underlying suit against the insured. The Court found no such duty to defend where the umbrella policy at issue stated: "We will investigate and defend 'suits' brought against an insured for a claim or suit that alleges damages from an 'incident' not covered under: a. 'scheduled underlying insurance'; and b. 'unscheduled underlying insurance' . . ." *Padilla*, 150 Cal.App.4th at 994. The policy further defined "unscheduled underlying insurance" as "insurance policies available to an insured, whether: (1) primary; (2) excess; (3) excess-contingent; or (4) otherwise; except the policies listed in the Schedule of Underlying Insurance." *Id.* Holding that the policy language dictated that where a primary insurer had defended, the language of the umbrella policy dictated that it did not have a defense duty, the Court made no ruling with respect to indemnity.

In discussing the insured's argument that a duty to defend was owed by the umbrella carrier, the Court noted, "[t]he insured's argument is not without considerable force . . . . But there is a core flaw in the logic. It confuses the obligation of the [primary carrier] to indemnify – which is indeed limited only to that increment of harm after March 1, 2001 – with the obligation of the [primary carrier] to defend a suit that includes an increment of harm after March 1, 2001." *Id.* at 996. With respect to defense, the Court recognized that there was a "complete" duty to defend even where

some, but not all, claims or damages were covered under a policy.[5] *Padilla* emphasized its holding pertained to the *defense* obligation alone: it reviewed policy language in the umbrella policies pertaining to that obligation and premised its opinion on law regarding the scope of that duty.

In this case, Gerling contends that Defendants have an obligation to contribute to the defense of the insured in the Underlying Actions. However, regardless of whether Defendants owed a duty of defense, they certainly have an obligation to contribute to the indemnification of the insured. The insuring agreements of both sets of policies at issue establish the attachment point – the point at which an excess carrier has a duty to indemnify – the exhaustion of specifically defined underlying policies. Again, the Homestead policies obligate Homestead to:

> pay those sums that the insured must legally pay as damages because of . . . property damage . . . caused by an occurrence which occurs during the policy period of this policy in excess of the sums payable as damages in the underlying insurance or would have been payable but for the exhaustion of the applicable limit of insurance. (Complaint ¶¶ 10-12)

The terms of the policy are explicit: Homestead was to pay damages when the scheduled policies exhausted, not when all applicable primary, or all other, or all unscheduled policies exhausted. And they were obligated to pay damages, regardless of any duty to defend.

Similarly, Great American's policies state:

> We will pay on behalf of the "Insured" those sums in excess of the "Retained Limit" that the "Insured" becomes legally obligated to pay by reason of liability imposed by law . . .

Great American also obligated itself to pay damages once particular primary policies were exhausted. Further, it did so without regard to any potential defense obligation.

Both Homestead and Great American seek to shirk their obligations relying on provisions dealing solely with the duty to defend. However, provisions regarding the duty to defend do not describe the duty to indemnify and do not limit the carriers' obligations regarding indemnity.

G. <u>If the Court Is Inclined to Grant Defendants' Motion to Dismiss, Gerling Should Be Granted Leave to Amend its Complaint</u>

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[5]The court further noted such a duty was prophylactic in nature under the Supreme Court's ruling in *Buss v. Superior Court*, 16 Cal.4th 35 (1997). As *Buss* made clear, however, a defending carrier could seek reimbursement from an insured, as the duty to defend entirely was "law imposed" as distinct from "contract imposed." *Padilla*, 150 Cal.App.4th at 999 n. 14.

In the event that the Court is inclined to grant either of Defendants' motions to dismiss, Gerling respectfully requests that it be given leave to amend its complaint pursuant to FRCP 15(a)(2). It is the express mandate of Rule 15(a)(2) that leave to amend "be given freely given when justice requires." *See, Allen v. City of Beverly Hills,* 911 F.2d 367 (9th Cir. 1990). As this case was filed only a few months ago, Defendants will not incur any undo prejudice if Gerling is allowed to amend its complaint. Accordingly, Gerling requests that if the Court is to rule in favor of Defendants' motions to dismiss, it be done without prejudice to Gerling filing a First Amended Complaint to rectify any insufficiency in its current pleading found by the Court.

Gerling also respectfully requests that any ruling on Defendants' motions be limited to the sufficiency of Gerling's complaint. Alternatively, if the Court is inclined to turn either of Defendant's motions to dismiss into a motion for summary judgment, Gerling asks for sufficient time in which oppose such a motion and to bring its own cross-motion for summary judgment on the issues raised.

IV. CONCLUSION

As both Homestead or Great American were required to provide coverage to Jonce upon exhaustion of their directly underlying polices, Gerling has alleged valid claims for Declaratory Relief and Contribution against both Homestead and Great American. Accordingly, Defendants' motions to dismiss must be denied. In the alternative, if the Court is inclined to grant either of Defendant's motions, Gerling requests that it be given leave to file an amended complaint.

Dated: June ___, 2008 MORALES, FIERRO & REEVES

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